



**A Report to the
Audit Committee**

Mayor
David Briley

Executive Director, MDHA
James E. Harbison

Audit Committee Members
John Cooper
Charles Frasier
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Brackney Reed

**Audit of Development Incentives
Managed by Metropolitan
Development and Housing Agency**

March 30, 2018

Metropolitan
Nashville
Office of
Internal Audit

EXECUTIVE SUMMARY

March 30, 2018



Why We Did This Audit

The audit was initiated to ensure that public and private stakeholders' interests are protected through defined goals, transparency, and accountability when incentivized development projects occur. In 2016, \$23 million in property taxes were allocated for tax increment financing incentives.

What We Recommend

- Create quantifiable goals to evaluate performance of development incentives.
- Improve financial/economic analyses for development projects.
- Enhance transparency involving incentive award/no-award decision making.
- Maintain and publish project analyses on the internet.

Audit of Development Incentives Managed by Metropolitan Development and Housing Agency

BACKGROUND

The Metropolitan Development and Housing Agency, hereinafter referred as MDHA, is a state-chartered organization tasked with redeveloping broadly defined blighted areas and generally encouraging the development of affordable housing within Davidson County. To achieve these ends, MDHA seeks to induce development, in part, with various development incentives such as:

- Payments in lieu of taxes.
- Discounted land sales and land write-downs.
- Development/redevelopment district creation.
- Tax increment financing (the focus of this audit engagement).

OBJECTIVES AND SCOPE

The objectives of this audit are to determine if MDHA:

- Practices and controls for tax increment financing development protect the interest of the public and private stakeholders.
- Informs the public regarding the true costs, benefits, and necessity of development incentives.
- Monitors and holds itself and developers accountable for achieving outcomes upon which incentive award decisions are based.
- Complies with applicable laws and regulations regarding tax increment financing incentives.

The scope of this audit is limited to urban incentivized development projects managed by MDHA, particularly through tax increment financing within the past ten years, where MDHA acts as the primary agency involved. Several developments awarded tax increment financing funds are not analyzed in this audit due to MDHA acting as a junior partner to one or more other government agencies such as the Industrial Development Board, or the Mayor's Office of Economic Development (examples include the Omni Hotel/Country Music Hall of Fame and the Sports Authority Ballpark).

WHAT WE FOUND

MDHA is actively taking steps to improve the transparency and general stewardship regarding its use of tax increment financing, particularly within the past few years. No instances of non-compliance with state and local statutes were observed.

GOVERNANCE

MDHA is overseen by a seven-member board of commissioners. Board members are nominated by the Mayor and approved by the Metropolitan Nashville Council for five-year terms.

Housing Authorities Law and the Uniformity in Tax Increment Financing Act codified in Tennessee Code Annotated § 13-20-201 *ff* and § 9-23 *ff*, details the requirements for redevelopment and tax increment financing. Additionally, the Metropolitan Nashville Council passed Ordinance No. BL2016-157 which among other things:

- Requires regular reporting on tax increment financing loans to both the Metropolitan Nashville Council and the Director of Finance for the Metropolitan Nashville Government (the annual tax increment financing report).
- Mandates that future tax increment financing loans to developers require the debt service portion of the taxes remain within the Metropolitan Nashville Government rather than be pledged towards servicing tax increment financing debt.
- Clarifies that tax increment financing revenue collected for future tax increment financing loans shall be returned to the Metropolitan Nashville Government General Fund once the loan is paid off unless the Metropolitan Nashville Council approves otherwise.

BACKGROUND

Tax increment financing allocates the increase in property tax revenue resulting from the redevelopment of an area to financing the development-related costs in the area.¹ It is the marriage of private (the developers') and public (the taxing districts') funds to facilitate a project that will benefit both interests where the project otherwise would not occur.²

Proponents of using development incentives, and more specifically, tax increment financing, to induce development, point to benefits such as: increasing the tax base and creating jobs; revitalizing blighted or distressed areas; promoting affordable housing; promoting other public goods such as green/open space, parks, historic preservation, and public transportation assets. Those seeking greater regulation and oversight of the use of tax increment financing cite problems such as: a lack of transparency; lack of binding requirements as to the benefits a development may produce; lack of cost/benefit analysis to taxpayers; granting tax incentives to companies who would have developed anyway; and diverting money from schools and other services.³

In 2014 local news reports raised concerns regarding MDHA's use of tax increment financing. Since that time, both MDHA and the Metropolitan Nashville Council have implemented measures to address said concerns. MDHA has sought to standardize the tax increment financing process through a formal application form that requires the stated financial need for tax increment financing along with an explanation of the use of these funds.

¹ Robert Bland, *Management Policies in Local Government Finance*, ICMA Press, Washington D.C., 2013, p. 185.

² Retrieved from <https://www.propertymetrics.com/blog/2016/10/17/how-to-analyze-tax-increment-financing-tif-projects>.

³ Tennessee Society of CPAs Journal, May/June edition (2017).

MDHA currently oversees 11 tax increment financing-eligible development/redevelopment districts (see Appendix A), primarily through its Department of Urban Development. MDHA also oversees the Capitol Hill redevelopment district, though this district is not eligible for tax increment financing. These districts require yes/no approval votes from the Metropolitan Nashville Council and are generally in close proximity to the urban core. The 11 districts carry \$171.8 million in tax increment financing loan balances from a tax increment financing loan capacity of \$498.5 million (much of which has already been used and repaid).⁴

Exhibit A – MDHA Redevelopment Districts Tax Increment Financing Remaining Capacity as of July 24, 2017

District Name	Created	Last Amended for TIF Capacity	Capacity	Remaining Capacity
Capitol Mall	1/17/1978	4/1/2014	\$230,000,000	\$ 0
Rutledge Hill	4/4/1980	4/1/2014	60,000,000	31,900,000
Arts Center	6/2/1998	4/1/2014	60,000,000	13,500,000
Jefferson Street	11/17/2005	4/1/2014	15,000,000	14,000,000
East Banks	2/29/1996	N/A	25,000,000	18,000,000
Central State	7/21/1999	N/A	7,500,000	7,500,000
Skyline	6/14/2007	N/A	5,000,000	4,800,000
Phillips-Jackson	9/21/1993	12/10/2013	50,000,000	7,400,000
Five Points	1/2/1990	3/4/2014	1,000,000	600,000
Bordeaux	8/10/2015	N/A	15,000,000	15,000,000
Cayce	8/10/2015	N/A	30,000,000	30,000,000
Total			\$498,500,000	\$142,700,000

Source: MDHA’s schedule of tax increment financing status as of July 24, 2017.

TAX INCREMENT FINANCING PROCESS

Tax Increment Financing-District Creation and Metropolitan Nashville Council Approval

The process for inducing tax increment financing development begins with MDHA’s creation of a proposed tax increment financing-eligible redevelopment district. During this phase, MDHA typically consults with an array of interests including the Metropolitan Nashville Government Planning Department, Office of the Mayor, Metropolitan Nashville Council representatives, and the citizens within the proposed area. Through these consultations, MDHA creates and internally approves a redevelopment plan that outlines the proposed geographic boundaries; land use restrictions; design principles; the dollar amount of the desired development; and the dollar amount of tax increment financing allocated for use. Next, the Metropolitan Nashville Council considers an ordinance, through public hearings, to ultimately approve or reject the development district creation. The public hearings are advertised in the *Tennessean* alerting the public and developers to the new district.

The base assessment used for tax increment financing redevelopment districts is established in Tennessee Code Annotated § 13-20-205 (a) (1):

“For properties subject to a redevelopment plan or urban renewal plan containing or amended to contain a tax increment financing provision approved prior to July 1, 2006, that portion of the taxes which would be produced by the rate at which the tax is levied each year by each taxing agency, upon the assessed value of such property as shown upon the assessment roll of the

⁴ See April 2017 Council Tax Increment Financing Report.

appropriate assessor, as of the date of the most recently determined valuation prior to the acquisition of such property by the authority (the assessed value being herein called the "base assessment") shall be allocated to, and when collected, shall be paid to, the respective taxing agencies as taxes levied by such taxing agencies on all other property are paid; provided, that in any year in which the actual assessment of the area comprising a redevelopment project is less than the base assessment, there shall be allocated and paid to the respective taxing agencies only those taxes actually produced by the application of the current tax rates against such actual assessment.

For properties subject to a redevelopment plan or urban renewal plan containing or amended to contain a tax increment financing provision approved after July 1, 2006, the base assessment of the property for purposes of this subdivision (a)(1) shall be determined as of the date of the most recently determined valuation prior to the date on which the redevelopment plan or urban renewal plan or amendment of the plan was approved by the applicable municipality or municipalities pursuant to § 13-20-203;”

Tax Increment Financing Request

For the typical tax increment financing development, a prospective developer will approach MDHA to discuss the outline of the proposed project. If the development generally fits within the redevelopment plan criteria, MDHA will require the developer to submit a tax increment financing application detailing why an incentive is necessary and how the incentive will be used.⁵ Developers are required to justify their request for an incentive through demonstrating a financial “gap” supported by pro forma financial statements and other necessary documentation. The assumptions used in the applications and pro forma financial statements are then analyzed by MDHA staff.

MDHA caps the amount of estimated future tax increment available for recapture (the amount of debt a tax increment financing development can support) based upon property values frozen at project “stabilization,” as opposed to estimating future real estate value appreciation in perpetuity. “Stabilization” is typically defined as the real estate value upon project completion or near completion.

Tax Increment Financing Request Analysis

MDHA then uses several forms of “but for” criteria when determining whether to incentivize a proposed development. “But for” analyses seek to demonstrate that a given development would not otherwise occur “but for” public incentives.⁶ Among the most commonly used by MDHA are internal rate of return and “gap” analyses which both seek to demonstrate that an incentive is necessary to create a “reasonable return” for the developer and, thus, induce development. MDHA uses tax increment financing incentives to help cover the costs of land acquisition, site preparation and desirable “public good” initiatives or amenities such as parking, green space, sidewalks, and so forth.

MDHA typically reviews tax increment financing requests internally with executive staff prior to submitting the proposal to the Development Committee of MDHA and then, subsequently, to the full MDHA Board of Commissioners. The MDHA Board of Commissioners will approve or reject the request. At times, when soliciting proposals for new development, MDHA will seek to include non-MDHA members in project and design review committees (i.e., architects, Metropolitan Nashville Government

5 Retrieved from <http://www.nashville-mdha.org/wp-content/uploads/2015/02/tif-application.pdf>

6 Retrieved from <https://www.propertymetrics.com/blog/2016/10/17/how-to-analyze-tax-increment-financing-tif-projects/>

Public Works Department representatives, contractors, and engineers) depending upon the size and needs of a project.

Development/incentive reviews typically focus on the following criteria:

- Developers' financial ability.
- Development's fit within the redevelopment plan.
- Developer assembled team qualifications (i.e., contractors, architects, and engineers).
- Terms of purchase, sometimes including financing terms.

Tax Increment Financing Loans

To finance the tax increment financing incentives, MDHA serves as the debtor for tax increment financing loans, pledging only future tax increments for repayment. Though MDHA approves the terms, the developers are responsible for securing financing for tax increment financing loans. This is generally accomplished through banks or private lenders. MDHA requires that the developers or another non-Metropolitan Nashville Government/non-MDHA party guarantee tax increment financing loans.

Development Agreement

Next, once the contours of both the proposed development and the tax increment financing loan terms are known, MDHA and the developers sign a development agreement that details, among other things, the developers' commitments, design guidelines, use restrictions, and the amount of tax increment financing to be awarded. Prior to the execution of the development agreement, it must first be reviewed and approved by the following parties:

- MDHA-chaired Design Review Committee that typically includes a district Metropolitan Nashville Council representative, architect, business or property owner, and a Metropolitan Nashville Public Works Department official.
- MDHA Office of the Executive Director.
- MDHA Board of Commissioners.

Project Commencement and Monitoring

As the development agreement is executed and the tax increment financing loan is closed, the developers may begin developing the site. The tax increment financing funds are then distributed for eligible expenses, often after the expenses have been incurred during construction. MDHA then monitors ongoing individual development projects for compliance with the development agreements, although there are no formal overall end-of-project evaluations.

MDHA submits a request for tax increment funds to Metropolitan Nashville Government Department of Finance and tracks payments of received funds.

OBJECTIVES AND CONCLUSIONS

1. *Do MDHA tax increment financing development practices and controls protect the interest of the public and private stakeholders?*

Generally yes. MDHA employs a number of strategies to protect the public's interests regarding tax increment financing used. However, continued improvements can be made. (See Observations A, B, C, D, E, F, and G.)

2. *Is the public meaningfully informed of the true costs, benefits and necessity of development incentives managed by MDHA?*

Generally no. Although all statutorily required information is presented in public as part of the Development Committee and Board of Commissioner meetings, MDHA acknowledges that more can be done in this area, and conveys a willingness to consider additional measures. But, MDHA also describes resource limitations combined with many competing priorities within the organization. (See Observations A, B, C, D, and G.)

3. *Is MDHA monitoring and holding itself and developers accountable for achieving the assumed outcomes upon which incentive award evaluations were based?*

Generally yes. MDHA's efforts generally consist of monitoring ongoing development projects for compliance with the development agreements. However, additional steps could be undertaken. (See Observation D.)

4. *Is MDHA in compliance with applicable laws and regulations regarding activities involving tax increment financing incentives?*

Yes. Of the projects and processes reviewed, no instances of non-compliance were observed.

AUDIT OBSERVATIONS

Internal control helps entities achieve important objectives, and sustain and improve performance. The Committee of Sponsoring Organizations of the Treadway Commission (*COSO*), *Internal Control – Integrated Framework*, enables organizations to effectively and efficiently develop systems of internal control that adapt to changing business and operating environment, mitigate risks to acceptable levels, and support sound decision making and governance of the organization. The audit observations listed are offered to assist management in fulfilling their internal control responsibilities.

Observation A – Development District Creation

Areas of concerns related to the creation of MDHA development districts exist:

- Although the purpose of development district creation is “blight removal,” as opposed to “economic development,” tax and economic-impact analyses have been limited in the past regarding the creation of development districts. A lack of tax and economic impact analyses could lead to a lack of informed debate regarding assumed costs and benefits of a given development initiative while increasing the difficulty associated with judging the outcomes of such initiatives.
- Quantifiable goals with which to measure the success of redevelopment districts on both an ongoing and end-of-district basis are not available. District goals tend to be general, such as statutorily defined blight removal or increased affordable housing. Lacking quantifiable goals increases the challenge of measuring the benefits relative to costs of development incentive programs.
- “Existing use” real estate appreciation/depreciation projections when calculating future tax increment is lacking. Instead, property values within a tax increment financing redevelopment district are frozen at the time of district creation, per statutory requirement. A risk associated with this is the possible overestimation of the amount of real estate tax appreciation (tax increment) attributable to incentivized development.
- Minutes for community meetings to solicit feedback are not always produced and retained. It is difficult to determine the level of MDHA responsiveness in instances where concerns are raised in community meetings when minutes are not consistently retained.

Criteria:

- *COSO*, Control Activities—Principle 10—The organization selects and develops control activities that contribute to the mitigation of risks to the achievement of objectives to acceptable levels.
- Government Finance Officers Association Best Practices - Creation, Implementation, and Evaluation of Tax Increment Financing (2017).⁷

Recommendations for management of MDHA to:

1. Conduct tax and/or economic impact analyses of a proposed redevelopment district creation or expansion, and make the results publicly available, prior to Metropolitan Nashville Government Council approval.

⁷ Government Finance Officers Association best practices, Creation, Implementation, and Evaluation of Tax Increment Financing (2017). Retrieved from <http://www.gfoa.org/creation-implementation-and-evaluation-tax-increment-financing>

2. Account for future real estate appreciation/depreciation with and without the to-be-approved development incentives when calculating tax increment estimates for development districts.
3. Create quantifiable goals for the creation of potential redevelopment districts such as projected real estate tax appreciation, the number of affordable housing units created, and so forth.
4. Record meeting minutes/summaries of district creation community meetings to include key issues discussed. Include a summary of how highlighted issues are addressed, if at all. Maintain records and make them publicly available.

Observation B – Individual Development Projects

Records of both the financial analyses used to justify incentives and internal review considerations, including developer and MDHA assumptions, are not always produced and/or available (though the trend has been towards greater analysis and documentation since 2014). When records are not available, it is difficult to analyze the decision-making processes including the utility, effectiveness, and return on investment of incentivized development initiatives.

MDHA also does not conduct formal overall end-of-project evaluations, including totals for all incentives associated with individual development projects.

Criteria:

- COSO, Control Activities—Principle 10—The organization selects and develops control activities that contribute to the mitigation of risks to the achievement of objectives to acceptable levels.
- Government Finance Officers Association Best Practices, Creation, Implementation, and Evaluation of Tax Increment Financing (2017)⁶ and Evaluating Data and Financial Assumptions in Development Proposals (2013)⁸.

Recommendations for management of MDHA to:

1. Prepare and retain detailed financial analyses which demonstrate the need (or the justification in cases such as desired “public goods” like parks, parking, and so on) for development incentives for each development being actively considered for incentives. Such analyses may include internal rate of return (IRR), “but for,” gap, and/or various cost-benefit analyses.
2. Create and retain records of the developer assumption review process, wherein key proforma, design and cost assumptions are vetted and approved by MDHA management.
3. Create formal end-of-project review and grading procedures for each project based on assumed benefits of a given project using criteria such as cost, timeline, compliance with approved designs, and so forth. Also include end-of-development incentive totals, with the dollar amounts associated with various incentives and from whom/where the incentives came. Include all costs associated with developments, such as site prep, infrastructure improvements, discounted land sales, land acquisition, and so forth.

⁸ Retrieved from <https://www.propertymetrics.com/blog/2016/10/17/how-to-analyze-tax-increment-financing-tif-projects/>

Observation C – Land Incentives Not Transparent

The total incentive value for redevelopment projects involving the sale or conveyance of public land is likely understated because the fair market value of the conveyed land is not consistently publicly disclosed.

Criteria:

- COSO, Control Activities—Principle 10—The organization selects and develops control activities that contribute to the mitigation of risks to the achievement of objectives to acceptable levels.
- COSO, Control Activities—Principle 15—The organization communicates with external parties regarding matters affecting the functioning of internal control.

Recommendations for the management of the MDHA to:

Clearly communicate the fair market value of public land (MDHA or Metropolitan Nashville Government), and the actual transacted value of land conveyed to private developers within MDHA redevelopment project analyses, and also within external reports communicating the total public investment in redevelopment districts and projects.

Observation D – Performance-Based Disbursement of Funds

MDHA’s developer agreements are not typically performance-based, meaning MDHA often does not condition incentive disbursement upon achieving agreed-upon performance goals. If a developer fails to achieve the terms of a particular agreement, such as the number of agreed upon parking spaces, and MDHA has already disbursed the incentive to the developer, MDHA may have limited options for recourse, aside from issuing stop-work orders, canceling the agreement, or litigation to seek specific performance.

Criteria:

- COSO, Control Activities—Principle 10—The organization selects and develops control activities that contribute to the mitigation of risks to the achievement of objectives to acceptable levels.
- Government Finance Officers Association Best Practices, Creation, Implementation, and Evaluation of Tax Increment Financing (2017)⁹ and Performance Criteria as a Part of Development Agreements (2013).¹⁰
- U.S. Public Interest Research Group Education Fund, Tax-Increment Financing (2011).¹¹

Recommendations for management of MDHA to:

Structure agreements in which disbursement of tax increment financing and other incentives are conditioned upon performance of agreed-upon performance measures.

⁹ See the Government Finance Officers Association best practices, Performance Criteria as a Part of Development Agreements (2013). Retrieved from <https://www.gfoa.org/performance-criteria-part-development-agreements>.

¹⁰ See the Government Finance Officers Association best practices, Creation, Implementation, and Evaluation of Tax Increment Financing (2017). Retrieved from <http://www.gfoa.org/creation-implementation-and-evaluation-tax-increment-financing>.

¹¹ U.S. PIRG Education Fund, Tax-Increment Financing (2011). Retrieved from <https://uspirg.org/sites/pirg/files/reports/Tax-Increment-Financing.pdf>.

Observation E – Tax Increment Financing Loan Selection

MDHA does not require developers to seek tax increment financing loan quotes from multiple lenders. A lack of competition among lenders for the tax increment financing loans could result in less competitive terms. Less competitive tax increment financing loan terms could lead to higher loan repayment and/or transaction costs, thus potentially less funds for redevelopment or to retain in the Metropolitan Nashville Government General Fund.

Criteria:

COSO, Control Activities—Principle 10—The organization selects and develops control activities that contribute to the mitigation of risks to the achievement of objectives to acceptable levels.

Recommendations for management MDHA to:

1. Require developers to produce tax increment financing loan quotes from three or more qualified lenders.
2. Justify in writing and obtain MDHA Board of Commissioners approval when lenders with less favorable terms are chosen.

Observation F – Development Agreement Monitoring and Compliance

During the course of development construction, MDHA lacks a standardized development agreement monitoring process, relying primarily on on-site inspections. Without standardized development monitoring, developments may not be completed in accordance with the agreement terms. Additionally, a standardized monitoring process, along with the retention of associated paperwork, could help inform the public regarding the return on investment and general performance of development projects.

Criteria:

COSO, Control Activities—Principle 10—The organization selects and develops control activities that contribute to the mitigation of risks to the achievement of objectives to acceptable levels.

Recommendations for management of MDHA to:

Create a standardized process to determine and document developer compliance with key performance measures agreed upon within development agreements.

Observation G – Additional Council Review Time and Data Disclosure Before Approval

Limited external oversight exists regarding MDHA's individual development incentive decisions. Several Metropolitan Nashville Council Planning Committee members expressed a dearth of both time and easily accessible data with which to determine the costs and benefits of MDHA's economic incentive-related operations. A lack of readily accessible and relevant data to the public can make determining the total investment, benefits, and utility of incentivizing development difficult.

Criteria:

- *COSO, Control Activities—Principle 10—The organization selects and develops control activities that contribute to the mitigation of risks to the achievement of objectives to acceptable levels.*

- *COSO, Control Activities—Principle 15—*The organization communicates with external parties regarding matters affecting the functioning of internal control.

Recommendations for management of MDHA to:

1. Offer to provide a presentation regarding industry best practices and the applicable regulations governing developer/deal fees to address Metropolitan Nashville Council members concerns related to MDHA's redevelopment programs.
2. Improve transparency by posting on the internet summaries and supporting documents for development project analyses.
3. Consider obtaining Metropolitan Nashville Council concurrence for individual development projects receiving total incentives above a significant threshold (such as developments receiving in excess of \$5,000,000 in total incentives).

Observation H - Tax Increment Financing Funds Capture Process

Oversight is lacking regarding the tax increment financing funds capture and disbursement process between MDHA and the Metropolitan Nashville Government Department of Finance.

The Metropolitan Nashville Government Department of Finance, who transfers tax increment financing funds to MDHA upon request, performs only limited oversight and review, primarily looking for inconsistencies between prior and current tax increment financing funds requests. This risks the possibility of disbursing amounts greater than allocated to MDHA without the ability to detect potential overpayments.

Of note, MDHA's tax increment financing funds invoice and capture process were evaluated by MCM CPAs & Advisors, an independent certified public accounting firm, through an agreed upon procedure engagement. MCM CPAs & Advisors reported no issues related to the procedures performed with the invoice and capture process for the period between October 1, 2013, and September 30, 2014.

Criteria:

*COSO, Control Activities—Principle 10—*The organization selects and develops control activities that contribute to the mitigation of risks to the achievement of objectives to acceptable levels.

Recommendations for management of the Metropolitan Nashville Government Department of Finance to:

1. Verify the amount of tax increment financing invoiced by MDHA is correct and track tax increment financing loan repayment schedules to ensure no overpayment occurs.
2. Monitor for compliance with Ordinance No. BL2016-157 pertaining to tax increment financing.

GOVERNMENT AUDITING STANDARDS COMPLIANCE

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our observations and conclusions based on our audit objectives.

METHODOLOGY

To accomplish our audit objectives, we performed the following steps:

- Researched theories, practices, rules, and regulations regarding tax increment financing.
- Interviewed key personnel within:
 - MDHA.
 - Metropolitan Nashville Council Office.
 - Metropolitan Nashville Government Department of Finance.
- Surveyed Metropolitan Nashville Council Planning Committee members.
- Reviewed and analyzed documentation for compliance with the Tennessee Code Annotated, Metropolitan Nashville Code of Laws, and other applicable laws, regulations, and policies.
- Reviewed information technology control systems.
- Evaluated internal controls currently in place.
- Reviewed sample selections to determine the effectiveness of internal controls.
- Considered risks associated with information systems.
- Considered risk of fraud, waste, and abuse.

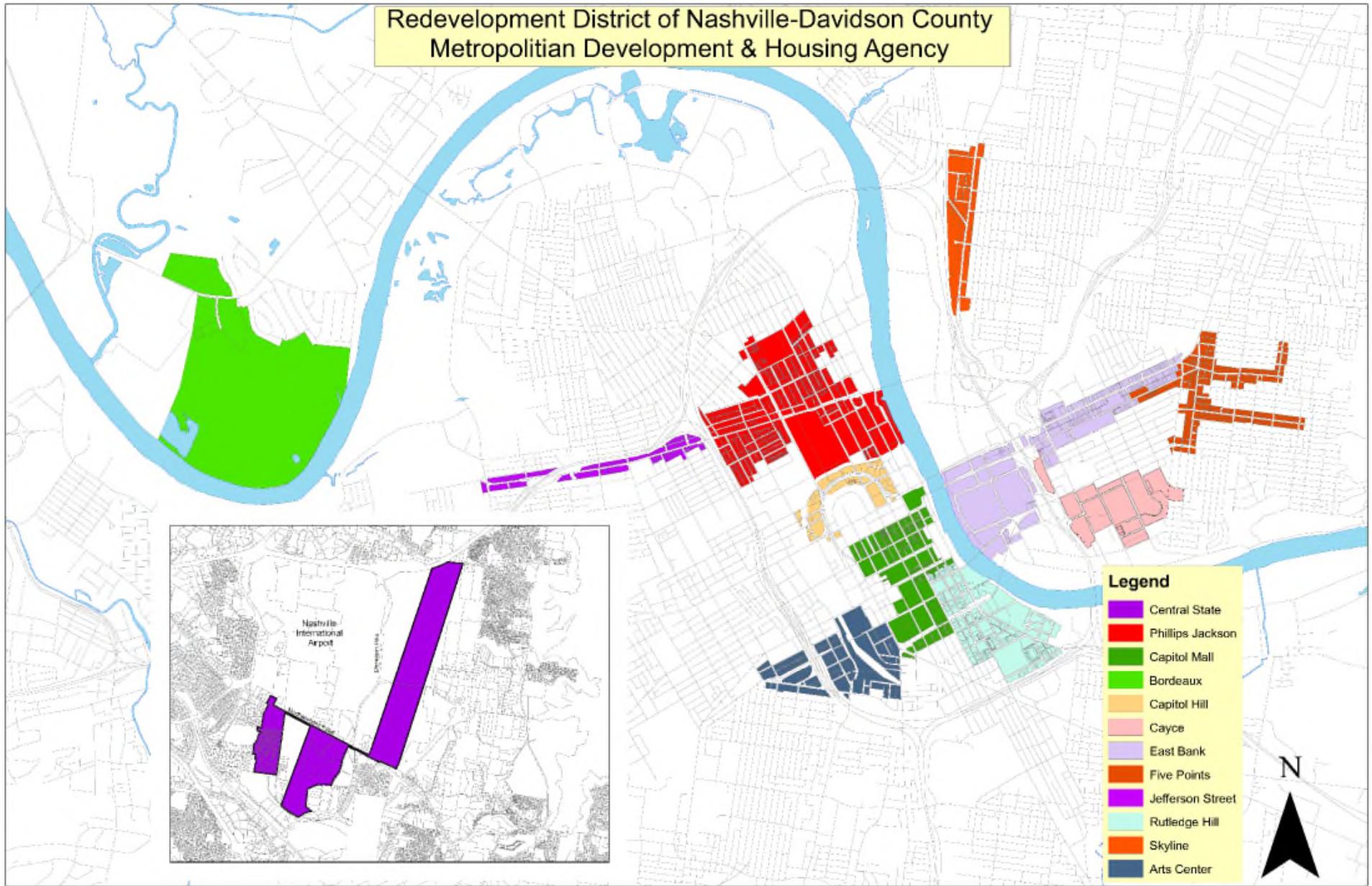
AUDIT TEAM

Ted Ciuba, MBA, Auditor-in-Charge

Qian Yuan, CIA, CISA, ACDA, CMFO, Quality Assurance

Mark Swann, CPA, CIA, CISA, ACDA, CMFO, Metropolitan Auditor

APPENDIX A – MDHA REDEVELOPMENT DISTRICTS



APPENDIX B – MANAGEMENT RESPONSE AND CORRECTIVE ACTION PLAN

Metropolitan Development and Housing Agency

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March 30, 2018

Mark Swann
Metro Auditor
Metropolitan Nashville Office of Internal Audit
404 James Robertson Parkway, Suite 190
Nashville, TN 37219

Re: Audit of Development Incentives managed by the Metropolitan
Development and Housing Agency.

Dear Mark:

MDHA has received the Audit of Development Incentives managed by the Metropolitan Development and Housing Agency completed by your office. Thank you for your thorough review.

We appreciate and concur with your determination that “No instances of non-compliance with state and local statutes were observed,” and that MDHA’s management of the Development Incentive Program is conducted in compliance with all applicable laws and regulations. As your audit found, MDHA is actively taking steps to improve the transparency and general stewardship of tax increment financing.

We appreciate your insightful recommendations and will continue to seek improvement. Many of the recommended actions are being implemented through current internal procedures and external announcements. Our attached comments address each of the Audit recommendations.

Please let me know if you have any questions.

Sincerely,



James E. Harbison
Executive Director

Attachment

cc: MDHA Board of Commissioners



METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY

DAVID BRILEY
MAYOR

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March 26, 2018

Mark Swann, Metropolitan Auditor
Metropolitan Nashville Office of Internal Audit
404 James Robertson Parkway, Suite 190
Nashville, Tennessee 37219

Re: Audit of Development Incentives Managed by Metropolitan Development and
Housing Agency

Mr. Swann,

This letter acknowledges that the Department of Finance has received the Development Incentives audit draft report completed by your office, and we accept the two recommendations applicable to the Department of Finance. Please find our acceptance, corrective action plans, and proposed completion dates on page 2 of this letter.

Please let me know if you have any questions.

Sincerely,

A handwritten signature in cursive script, appearing to read "Talia Lomax-O'dneal".

Talia Lomax-O'dneal, Director
Department of Finance

APPENDIX B – MANAGEMENT RESPONSE AND CORRECTIVE ACTION PLAN

We believe that operational management is in a unique position to best understand their operations and may be able to identify more innovative and effective approaches, and we encourage them to do so when providing their response to our recommendations.

Recommendation	Concurrence and Corrective Action Plan	Proposed Completion Date
<i>Recommendations for management of MDHA:</i>		
<p>A.1 - Conduct tax and/or economic impact analyses of a proposed redevelopment district creation or expansion, and make the results publicly available, prior to Metropolitan Nashville Government Council approval.</p>	<p>Complete. With the creation of the Donelson TOR, MDHA has expanded its analysis of existing and proposed tax base in the district.</p>	<p><i>Currently being done.</i></p>
<p>A.2 - Account for future real estate appreciation/depreciation with and without the to-be-approved development incentives when calculating tax increment estimates for development districts.</p>	<p>Complete. The results are available for public review and account for natural county wide growth plus anticipated additional growth with the implementation of the district.</p>	<p><i>Currently being done.</i></p>
<p>A.3 - Create quantifiable goals for the creation of potential redevelopment districts such as projected real estate tax appreciation, the number of affordable housing units created, and so forth.</p>	<p>Complete. Specific uses for TIF are intended to incent specific goals for development, such as affordable housing, commercial and so forth. The redevelopment plan provides guidance for how TIF will be allocated to achieve these goals. Moreover, the redevelopment plan amendment process allows for this guidance to be modified as the redevelopment district evolves over the 30-year term of the district.</p>	<p><i>Currently being done.</i></p>
<p>A.4 - Record meeting minutes/summaries of district creation community meetings to include key issues discussed. Include a summary of how highlighted issues are addressed, if at all. Maintain records and make them publicly available.</p>	<p>Accept. Sign in sheets are recorded for each meeting. Currently, comments from previous meetings are summarized and provided as an initial agenda item at the beginning of each community meeting. Moving forward, minutes will be maintained for each meeting and made publically available on the MDHA website.</p>	<p><i>5/1/2018</i></p>
<p>B.1 - Prepare and retain detailed financial analyses which demonstrate the need (or the justification in cases such as desired “public goods” like parks, parking, and so on) for development incentives for each development being actively considered for incentives. Such analyses may include internal rate of return (IRR), “but for,” gap, and/or various cost-benefit analyses.</p>	<p>Complete. The TIF applications submitted by developers include this information. MDHA analyzes the data submitted prior to recommendation of approval or disapproval of a TIF application.</p>	<p><i>Currently being done.</i></p>

APPENDIX B – MANAGEMENT RESPONSE AND CORRECTIVE ACTION PLAN

Recommendation	Concurrence and Corrective Action Plan	Proposed Completion Date
B.2 - Create and retain records of the developer assumption review process, wherein key proforma, design and cost assumptions are vetted and approved by MDHA management.	Complete. The TIF application and analysis is retained for all approved projects.	<i>Currently being done.</i>
B.3 - Create formal end-of-project review and grading procedures for each project based on assumed benefits of a given project using criteria such as cost, timeline, compliance with approved designs, and so forth. Also include end-of-development incentive totals, with the dollar amounts associated with various incentives and from whom/where the incentives came. Include all costs associated with developments, such as site prep, infrastructure improvements, discounted land sales, land acquisition, and so forth.	Complete. The Development Agreement outlines the TIF eligible expenses, and the TIF applied to those expenses. In addition, the TIF loan documents codify the uses. A certification of compliance demonstrates satisfactory completion.	<i>Currently being done.</i>
C.1 - Clearly communicate the fair market value of public land (MDHA or Metropolitan Nashville Government), and the actual transacted value of land conveyed to private developers within MDHA redevelopment project analyses, and also within external reports communicating the total public investment in redevelopment districts and projects.	Accept. MDHA will estimate the fair market value of MDHA or Metro-owned land being disposed of in a transaction. Additionally, MDHA will continue to disclose the “use value” of the property as prescribed by state statute.	5/1/2018
D.1 - Structure agreements in which disbursement of tax increment financing and other incentives are conditioned upon performance of agreed-upon performance measures.	Complete. Performance measures are outlined in the development agreement and the TIF financing agreements. Disbursements are made according to those documents with project completion guarantees required by the developer.	<i>Currently being done.</i>
E.1 - Require developers to produce tax increment financing loan quotes from three or more qualified lenders.	Accept. MDHA will require two or more quotes for TIF loans.	5/1/2018
E.2 - Justify in writing and obtain MDHA Board of Commissioners approval when lenders with less favorable terms are chosen.	Complete. MDHA does not approve lenders with less than favorable terms; often, the criteria that determine the most favorable lender is not exclusive to the interest rate, but also include floating or fixed rate, disbursement provisions, and other requirements to include fees. MDHA considers all factors and makes the best business decision for the loan.	<i>Currently being done.</i>
F.1 - Create a standardized process to determine and document developer compliance with key performance measures agreed upon within development agreements.	Complete. This is currently being done in the Urban Development office.	<i>Currently being done.</i>

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<p>G.1 - Offer to provide a presentation regarding industry best practices and the applicable regulations governing developer/deal fees to address Metropolitan Nashville Council members concerns related to MDHA's redevelopment programs.</p>	<p>Complete. MDHA sponsors two informational briefing sessions each year where all MDHA programs, statutes, rules, regulations and best practices are presented, with a focus on the two programs MDHA manages for Metro Nashville: Redevelopment Districts and LIHTC PILOT's. The most recent presentation was November 9th, 2017. MDHA is available to provide additional presentations to Council as desired.</p>	<p><i>Currently being done.</i></p>
<p>G.2 - Improve transparency by posting on the internet summaries and supporting documents for development project analyses.</p>	<p>Complete. MDHA staff and the developer present a detailed briefing to justify all expenses to the MDHA Board of Commissioners to approve all TIF allocations. This briefing is made available along with the Minutes of the Board meeting. In addition, the TIF application is available upon request.</p>	<p><i>Currently being done.</i></p>
<p>G.3 - Consider obtaining Metropolitan Nashville Council concurrence for individual development projects receiving total incentives above a significant threshold (such as developments receiving in excess of \$5,000,000 in total incentives).</p>	<p>Reject. The essence of a redevelopment district is to create a plan to eliminate deleterious uses. MDHA creates the plan that is subsequently approved or rejected by the Metropolitan Council. The Council approved plan authorizes MDHA to utilize a specified amount of TIF debt for implementation. It is MDHA's responsibility to implement the plan as approved, using its judgment on how to best utilize the debt capacity delegated.</p>	<p>N/A</p>
<p><i>Recommendations for management of the Metropolitan Nashville Government Department of Finance to:</i></p>		
<p>H.1 - Verify the amount of tax increment financing invoiced by MDHA is correct and track tax increment financing loan repayment schedules to ensure no overpayment occurs.</p>	<p>Accept. Metro Finance will coordinate with MDHA and engage an independent accounting firm to perform agreed upon procedures regarding the tax increment financing for the tax year 2016 and all subsequent tax years to assure that payment to MDHA are accurate and that the process is in compliance with regulations.</p>	<p>10/31/2018</p>

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Recommendation	Concurrence and Corrective Action Plan	Proposed Completion Date
<p>H.2 - Monitor for compliance with Ordinance No. BL2016-157 pertaining to tax increment financing.</p>	<p>Accept. Metro Finance will coordinate with MDHA and engage an independent accounting firm to perform agreed upon procedures regarding the tax increment financing for the tax year 2016 and all subsequent tax years to assure that payment to MDHA are accurate and that the process is in compliance with regulations.</p>	<p><i>10/31/2018</i></p>